

An Analysis of Credit for Reinsurance Regulation in the United States

**An Honors Thesis (HONRS 499)**

by

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A handwritten signature in black ink, appearing to read 'Kevin Gatzlaff', written in a cursive style.

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### **Abstract**

Insurance regulation is not new to the United States and serves a vital purpose in protecting the United States public and the insurance industry from fraud and other abuses. One important and long lasting reinsurance regulation is the credit for reinsurance regulation that was been in use since 1984. This paper will discuss creation of the United States credit for reinsurance regulation as well as the recent changes brought about by the Dodd-Frank Wall Street Reform and Consumer Protection Act. While discussing the previously mentioned subjects the paper will also examine why the regulation was created by discussing past reinsurance abuses, show the long history of the regulation's creation by the National Association of Insurance Commissioners, and the recent modifications brought about by the United States federal government. Finally, this paper analyzes how the changes will impact how the regulation is used in the United States and how this will impact the insurance industry.

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**Introduction**

Insurance regulations, since their inception in New Hampshire in 1851, have served to control and direct insurance companies and standardize procedures and processes. Among the multitudes of insurance regulations currently in place in the United States there are a collection of regulations governing credit for reinsurance; these regulations are both controversial and evolving.

The term *reinsurance* refers to the area of business in the global insurance industry where direct insurers (ceding insurers) pay larger insurance companies to take blocks of their business. Consequently, when a claim comes in for these policies the reinsurance company pays the direct insurer who then will pay the policyholder. When a United States ceding insurer cedes risk to a reinsurer, it desires to obtain credit for that reinsurance on its financial statements filed with the state insurance regulators. Before the creation of a credit for reinsurance regulation ceding insurers would claim ceded risk as an asset regardless of the fact that the reinsurer might not be stable or dependable in case of insolvency. This created a situation where the ceding insurers were not confident that reinsurers would be able to pay and therefore policyholders also had uncertainty on receiving benefits. Due to these past abuses, the majority of states now impose regulation on the time period in which a ceded insurer can claim the ceded risk as an asset. Currently, the insurance companies are regulated by the states in which the companies are located. Due to this there are as many regulations for reinsurance as there are states in our nation. Thus, a U.S. insurer cannot take a financial credit for business ceded to a reinsurer on their financial statements unless the company can meet the specific requirements determined by the individual state in which the company is domiciled.



The importance of receiving credit for reinsurance cannot to be overstated. Receiving credit for reinsurance allows an insurer to increase its surplus and expand its capacity to write new business in the United States. Therefore, the regulation of this credit determines the potential surplus cash a company may have and is in many ways vital to the growth of insurance companies. Credit for reinsurance laws and regulations are now a key component of reinsurance regulation in the United States. However, the road to the creation of this regulation has not been easy and without controversy. Since its creation in 1984, discussion has raged over some key issues in the credit for reinsurance regulation. Today, credit for reinsurance is still a vehemently debated topic; this discourse has caused some drastic changes to occur in the past two years. Overall, the regulation is definitely effective in stopping ceding insurers from abusing reinsurance credit; however, this regulation will need to continue to evolve and adapt to the needs of the insurance industry in the future and may continue to be controversial in nature.

### **Creation and Purpose of the NAIC**

Historically, the insurance industry in the United States has been regulated almost exclusively by the individual state governments. Prior to the 1870s, there was no coordination between the states regarding insurance regulations. This caused a great diversity of laws and interpretations between states, which translated into differing financial impacts upon companies based on their domicile. These differing regulations made it difficult for insurance companies to grow across states, as creating business in different states meant following increasingly more regulations. Historically, this had not been an issue in the past as insurance companies often did business in only one or two states. It was relatively simple for them to conform to the regulations in both states. However, by 1871, insurance companies were expanding their businesses across numerous states. With this broadening of territories and expansion of business came unforeseen

complications. Now, instead of a company having to follow one or two states regulations, the company had to follow five or six states laws.

In 1871, to combat this issue and work on possible solutions, a group of state insurance regulators founded an organization called the National Association of Insurance Commissioners (NAIC). The purpose of this group was to help coordinate regulations for insurers who were located in more than one state. The first major step taken by the NAIC was to develop a template for insurance companies to use when the companies submitted financial reports. Making all the states identical was the first step towards making it easier for insurance companies to expand their business beyond one or two state boundaries ("About the NAIC," 1999). Today, the NAIC is responsible for setting the United States standards and establishing parameters that will allow insurance companies to work effectively and efficiently. The NAIC serves to coordinate laws between states and are governed by the chief insurance regulators from the fifty states, the District of Columbia and five U.S. territories.

### **History of the Credit for Reinsurance Regulation in the United States**

In 1949, seventy-eight years after being founded, the NAIC began to notice that some disturbing abuses in reinsurance were being committed in different states. One of these abuses was the allowance of credit for non-admitted reinsurance. A subcommittee was assembled to study the question of reinsurance issues. In 1950 the subcommittee submitted a report at the annual NAIC meeting. In this report, it was recommended that credit for reinsurance ceded “be based upon the actual value of the reinsurance and the security underlying the collectability and not on the basis of the license of the reinsurer” (NAIC, 1950). In essence, what the subcommittee stated was that credit should be based on the actual value and security of the asset and not on whether a company was licensed or not. However, even though credit for reinsurance

was now an issue that the NAIC recognized, there was no action taken at that time. The issue of credit for reinsurance and how to fix the problem was to be a topic of discussion at NAIC meetings for more than three decades. The first detailed description of how credit for reinsurance regulation was set up came in the 1980s in a report titled *Reinsurance Problems and Solutions: An Illinois Alternative*, published by the Illinois Department of Insurance. This report gave a clear picture of credit for reinsurance in the early 1980s.

*“Reinsurance Problems and Solutions: An Illinois Alternative”* (1982) stated that: Every state permits domestic insurers to take annual statement credits for reinsurance cessions made to "admitted insurers." However, state insurance laws and regulations appear to be quite diverse in defining their terms. Illinois statutes for example, permit domestic companies to ceded to any insurer, regardless of size, authorized to transact the direct business of insurance in Illinois; conversely, except in rare circumstance, reinsurance credit may not be taken for reinsurance ceded to an unlicensed company regardless of its financial standing... Even those states which only authorize reinsurance credit for cessions made to particular insurers allow credit if the ceding company holds some sort of collateral, such as actual funds or letters of credit, to the extent credit is taken.

Around the same time, the abuses of credit for reinsurance were again brought to the attention of the insurance community. The Illinois Department of Insurance submitted a report to the Reinsurance Syndicates and Pools and the Anti-Fraud Task Forces in 1982. In this report, the Illinois Department of Insurance advocated steps to curb fraudulent reinsurance practices and suggested ways to detect fraud earlier. One of the suggestions proposed was that a model law on reinsurance be created. This law should include a statement of financial standards for assuming reinsurers, the establishment of accounting for reinsurance transactions, and reserve credits. It was also suggested that this law contain circumstances for early approval of reinsurance arrangements, required provisions for reinsurance contracts and financial reporting, and disclosure of certain reinsurance transactions. As a result of the work done by the Illinois

Department of Insurance, the NAIC task forces refocused on the credit for reinsurance issue, and the first model law addressing credit for reinsurance was adopted in June 1984(NAIC, 1984).

Since 1991, when the NAIC adopted a model for reinsurance regulation different from the 1984 model law that further specified requirements for allowing credit for reinsurance, the model law and regulation has remained fairly constant. Although there have been minor changes to the law and regulation since 1991, the basic regulation and critical terms have remained consistent.

### **Structure of the Original Model**

The first NAIC model regulation released provided that the reinsurance of a direct insurance company is treated as an asset on the direct insurer's financial statement as long as one of four requirements are met. The first requirement that the direct insurer has the option to meet is that the reinsurer be licensed in the same state as the direct insurer. This is the simplest and most ideal circumstance because it allows for the regulators and the ceding company to be following the identical regulations as the ceding insurer.

The second regulation requirement that a reinsurer may meet is that of being “accredited.” Accredited means that the reinsurer is in compliance with certain accreditation requirements set forth in the model law. These requirements include submitting to the jurisdiction of the domicile state and examination by the domicile state (Hall, 2004). Also, the reinsurer must already be licensed in at least one state, and the company must file an annual financial statement with the company’s domicile state. Another requirement that must be met for a company to receive reinsurance credit by the reinsurer being accredited involves the reinsurer holding a policyholder surplus of at least \$20 million of funds in trusts. This would ensure, in the

case of a catastrophic situation, that the company would be able to provide the funds to the ceded insurer, so that the insurer could then pay its policyholders.

The third requirement that the reinsurer may meet to allow the ceded insurer to receive reinsurance credit is that the reinsurer is licensed in another state that is determined to be “substantially similar” to the state where the direct insurer is located. It is noteworthy that all states decided to follow, in whole or in part, the NAIC model for the regulation when the model was released. Therefore, most states today are governed by regulations that are quite similar to each other.

The last requirement that the reinsurer may meet is for the reinsurer to establish a trust fund where it can secure its liabilities for multiple creditors. This requirement insures that the reinsurer can provide collateral. There are two approaches to setting up this collateral. The first way is to form a multiple beneficiary trust to secure its gross liabilities to all U.S. ceding insurers, plus a \$20 million surplus. The other approach is to form a single beneficiary trust of letter or credit with the ceding company as the beneficiary or by the withholding of funds by the ceding insurer. This last requirement is accompanied by a stricter set of rules governing what the regulators need in the form of informational filings from the reinsurer. In some cases, even if the reinsurer does not meet the requirements for reinsurance to be treated as an asset, it can still be allowed as a deduction from liability through letters of credit or trust funds. It should be noted that this approach is seldom if ever used in practice (Hall, 2004).

### **Current Model**

The basic structure of the credit for reinsurance regulation has not drastically changed in the last nineteen years. All of the requirements that were in the first NAIC model are still in place in all fifty states, District of Columbia, and four territories. Small changes in the strength of the

regulations have been made in thirteen states. The requirements for allowing reinsurance to be an asset on the direct insurer's financial statement are basically the same for all states with slight changes in how a few requirements must be made. Requirements include that a reinsurer be licensed to sell insurance in the state where the direct insurer is located, or in a state that is accredited by the NAIC. A prerequisite that has undergone slight modification is the requirement that the reinsurer is licensed in a state that is "substantially similar" to the state where the direct insurer is located. In the current model, about ninety-five percent of the states also require that the company maintain a surplus of \$20 million and submit their records to be analyzed by the insurance department of the state. Another set of requirements for the substantially similar option is that the company does not apply to pooling arrangements in the same holding company (Hall, 2004).

The most significant change from the first NAIC model to the current model has been the increase in required information that reinsurers must provide to the commissioners of each state in which the reinsurers do business. An example of this is in the fourth type of option where the reinsurer may maintain a trust fund in a qualified United States financial institution for payment of valid claims. Currently, when a reinsurer receives credit through this option, the company must report annually to a commissioner. This information must be substantially similar to what is reported to the NAIC in the annual statement form. It has also become common practice to demand that the reinsurer formally state that the company must submit to the state of the ceded insurer to examine books and records and pay the expense for the insurance department to provide the examination. A significant change made to the credit for reinsurance regulation came in 1997. It came to the attention of the states that a few of the states required that all ceded insurers have reinsurance credit. In these cases, no reinsurer could be denied certification. Due to

this situation, a qualification was added to the regulation stating that if the reinsurer did not meet the criteria of being licensed, accredited, licensed in a state that was substantially similar, or maintain a trust fund, the reinsurer could still be considered only where reinsurance is required by law (Hall, 2004).

## **Debated Issues**

### *Insolvency Clause*

Despite the fact that the credit for insurance regulations has remained largely unchanged for the past nineteen years, there have been a number of controversial issues raised in regards to its ramifications and implications. The first issue that has caused concern deals with the wording of the insolvency clause in regulation. Basically, an insolvency clause requires that, in the event of the insolvency of the direct insurer, all reinsurance payments will be made to the ceded insurer without reductions. It is interesting to note that when it comes to the topic of insolvency, the NAIC has not been able to make an expedient decision on how to address this topic. In 1989, the NAIC attempted to make a draft of this clause, but it was abandoned due to what seemed to be an irreconcilable difference between regulators in New York and California (Hall, 2004).

In 1993, the issue of insolvency was brought up by the NAIC again when receivers entered into the insolvency clause debate. As part of the NAICs effort to amend the Insurers Rehabilitation and Liquidation Model Act, the NAIC suggested specific insolvency language. The suggestion made was that an insolvency clause did not have to be included in a reinsurance agreement as long as no credit for reinsurance was going to be taken. However, both the insurance industry and its regulators objected to this proposal. By December 1994, a compromise was finally reached. As of 1994, all reinsurance agreements must include in their contracts a clause that states that in the event the ceded insurer becomes insolvent, the reinsurer is

responsible for payments under the contract. In addition, if any reinsurance agreement contract does not contain an insolvency clause it will be construed to include the prescribed language, regardless of whether the ceding insurer took credit for reinsurance recoveries. Contracting parties can avoid this result by including their own insolvency clause language in the contract even when no credit for reinsurance is being considered. Since this decision, all fifty states, the District of Columbia, and the four territories have added this to their credit for reinsurance regulations. As of 1995, the regulation remained unchanged; however, dramatic changes occurred in 2011 (Hall, 2004).

#### *Multiple Creditor Trust Provisions*

Another area where debate has raged surrounds the issue the handling of multiple creditor trust provisions. In accordance with the multiple creditor trust provisions of the 1991-2010 model regulation, a ceding insurer is allowed to take credit for reinsurance ceded to a non-domestic reinsurer as if the company were a licensed reinsurer. However, this nondomestic reinsurer is required to secure its U.S. liabilities in a U.S. financial institution and must maintain a trusted surplus of at least \$100 million. The difficulty inherent in this trust fund method was that it consisted primarily of premiums payable to an individual underwriter in connection with U.S. business. Individual underwriters are obviously not truly joint since one underwriter is not responsible for the debt of other underwriters. The \$100 million of the trusted surplus is held jointly for the benefit of all policyholders, but one underwriter is not responsible for the debt of the other. The concern was that if one underwriter could not pay his debt, none of the other underwriters were obligated to pay that debt. This could lead to a dangerous situation for a ceding insurer who may not be fully covered (Hall, 2004).



In 1993, the Reinsurance Association of America (RAA) suggested that a change be made to the credit for reinsurance regulation that would require all multiple creditor trusts to be held on a joint basis. The RAA felt a joint trust was necessary to guarantee that ceding insurers taking the credit for reinsurance ceded to a reinsurer would be adequately collateralized, regardless of the amount of funds that an individual underwriter maintained in the trust. The NAIC looked into this matter by forming a subcommittee to analyze the issue. However, this subcommittee then recommended that this issue should be determined by individual states. Today, all but thirteen states allow for joint trusts or multiple creditor trust funds with each having different qualifications and requirements. It should be noted that while all, except the thirteen states, decided individually, the states are almost identical as it makes the business of reinsurance easier to regulate.

### *Surplus Requirements*

The amount of surplus that assuming reinsurers, both domestic and nondomestic, should be required to maintain has also been a recurring topic of discussion for the NAIC. Starting in June 1984, the NAIC adopted a requirement that reinsurers qualifying under the "substantially similar" provision maintain, at a minimum, the same capital and surplus required of a domestic insurer in the ceding insurer's state of domicile. However, in 1998, the Reinsurance Task Force established a committee, called the Reinsurance Advisory Committee, to consider whether a separate license should be established for reinsurers (Hall, 2004). This committee concluded that instead of having a separate reinsurance license, an insurer assuming reinsurance liabilities should be required to increase its surplus. Not surprisingly, this issue continues to be controversial even at the federal level, where proposals to regulate solvency of reinsurers are being discussed.

Some reinsurance companies have supported a minimum requirement of \$50 million for the assumption of reinsurance by professional reinsurers. However, small companies holding some reinsurance business have opposed even a \$5 million threshold as it will make them less competitive and might remove them from the market entirely (Hall, 2004). Today, the minimum of capital and surplus is decided on the state level. This topic is one area where there is not one hundred percent consensus; however, while not the same for all states, the states tend to clump together in three groups. One group requires a minimum of \$50 million, another \$100 million, and the last with \$5 million.

#### *Domestic vs. Licensed Insurers*

The model that was in place from 1991 through 2010, and for most states is still in place, has not differed much in the nineteen years that it has been in use. The basic structure of the credit for reinsurance regulations is the same for all fifty states, District of Columbia, and four territories with some small changes in thirteen states to loosen or strengthen the regulations. One of the places where these thirteen states have departed from the NAIC's Credit for Reinsurance Regulation Model was over the issue of domestic versus licensed reinsurers. Since credit for reinsurance's birth in 1991, there has been considerable disagreement among regulators and between some regulators and the insurance industry concerning the extraterritorial application of credit for reinsurance laws. These disagreements led thirteen states to apply for their own regulations, through interpretation or statute, to a licensed company instead of on a domiciliary basis.

By law, a company is domiciled when it is a permanent resident in a particular state jurisdiction. A company can remain domiciled in a jurisdiction even after the company has left it, if the company has maintained sufficient links with that jurisdiction or have not displayed an

intention to leave permanently. A corporation's place of domicile is equivalent to its place of incorporation. For the thirteen states that modified their regulations, ceding insurers that normally would have to follow the laws of the company's state of domicile in calculating reinsurance and other credit, now must follow different regulations if it's licensed in any of the thirteen states that deviated from the model regulation. The insurance industry and the regulators dislike this action because the industry believes that it undercuts the NAIC accreditation program and the reliability and effectiveness of state regulation.

### *Non-Domestic Reinsurers*

The largest and most controversial issue that the credit for reinsurance regulation has faced concerns the handling of non-U.S. reinsurers. Even as early as the 1990s, the United States Congress was beginning to discuss reinsurance-related abuses and had begun to suggest that the regulation of reinsurance be transferred from the states to a Federal Commission. The domestic reinsurance industry and the NAIC have recognized that there is need for federal assistance in the area of foreign reinsurers. In 1992, the NAIC adopted a Non-U.S. Insurer Act. In this act a non-U.S. direct insurer is prohibited from writing business in the United States unless it is approved by the NAIC (Hall, 2004). The act set forth requirements for NAIC approval and allowed for the Department of Treasury to act as an oversight authority. The provisions of the NAIC Non-U.S. Insurers Act also reduced the trust fund required of some multiple creditor trusts from \$20 million plus an amount of U.S. liabilities, to only \$5 million in total.

Overall, the Non-U.S. Insurer Act was created to centralize authority with respect to nondomestic insurers and reinsurers and maintain the current practices with regard to their regulation. However, the consequence of this act was unknowingly granting a unique advantage to foreign companies. This advantage stemmed from the foreign companies only being required

to apply for the NAIC approval once, where domestic companies would still have to continue with the burden of state-by-state system of regulation, forcing them to deal with each state individually. This would allow foreign companies to more easily enter into the United States insurance market. The ease with which foreign companies may enter the United States market was enhanced in 2010, when the federal government passed into law more changes to the credit of reinsurance regulation.

### **Dodd-Frank Reform and Consumer Protection Act**

For the first nineteen years of the regulation, the format remained relatively the same for all states, territories, and the District of Columbia. However, starting in January 2011, states began slowly starting to change the credit for reinsurance regulations. It should be noted that while the changes are in many ways not drastic compared to the relatively small changes seen in the past years, the changes seen after 2010 have been dramatic. The cause of these changes was that President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act into law on July 21, 2010. While this legislation was mainly designed to address issues arising from the 2008 financial crisis, there were two provisions that related to foreign insurers that assume risk from United States ceding insurers (Kelly, Potter & Dembeck, 2011). These provisions appear in Title V, "Insurance" of the legislation. Contained within the Dodd-Frank Act is the Non-admitted Insurance and Reinsurance Act (the "NRRA") comprised of sections 511-542 of the Dodd-Frank Act of 2010 §531(a) where Congress decreed that credit for reinsurance regulations had to be changed to allow for more freedom for non-U.S. reinsurers (Dunham, Hill, Kelly, Potter & Dembeck, 2010). It should be noted that the United States federal law (the McCarran-Ferguson Insurance Regulation Act of 1945) declares that it is the intent of the U.S. Congress that the business of insurance be regulated by the states and that no act of Congress

may be construed to supersede any state law for the purpose of regulating the business of insurance unless the act specially relates to the business of insurance. Since the NRRA §531(a) specifically relates to the business of insurance it allows the federal government to supersede the state's credit for reinsurance regulation.

The NRRA §531(a) provides that, if the ceding insurer's domestic state is accredited by the NAIC (or has financial solvency requirements substantially similar to the requirements necessary for NAIC accreditation) and the domestic state recognizes credit for reinsurance for the ceding insurer's ceded risk, then no non-domestic state may deny such reinsurance credit. Since all states are currently NAIC accredited, this preemption of non-domestic state reinsurance credit rules afforded under NRRA §531(a) will extend to a ceding insurer domiciled in any state. The NRRA §531(a) became effective as of July 21, 2011 and applies to all reinsurance agreements for which the credit for reinsurance is claimed by a U.S. ceding insurer on or after the before mentioned date, whether or not the reinsurance agreement is entered into or effective before, on or after that date. It should be noted that NRRA §531(a) merely preempts nondomestic state reinsurance credit rules and does not change the fundamental terms of any existing or new reinsurance agreement which may impose requirements greater than those required under individual states' laws (Dunham, Hill, Kelly, Potter & Dembeck, 2010).

This is also applicable to nondomestic reinsurers who deal with credit for reinsurance regulations is NRRA §531(b) (4). This provision provides that all laws, regulations, provisions, or other actions of a ceding insurer's nondomestic state are preempted to the extent that the company must in other cases apply to the laws of the state to reinsurance agreements of nondomestic ceding insurers. Therefore, if a U.S. ceding insurer enters into a reinsurance

agreement on or after July 21, 2011 where the insurer would have to file in a nondomestic state then NRRA §531(b) (4) preempts that nondomestic state filing. From July 21, 2011 the company would only have to file in the state where the ceding insurer is located.

#### *General Impact of Dodd-Frank Act*

In many cases, the impact on non-domestic reinsurers that have a single reinsurance agreement security will be a basic simplification of the regulations that the company must follow. After July 21, 2011, non-domestic reinsurers must comply with the laws where the company is located instead of complying with the laws in every state and territory in which the company does business (Dunham, Hill, Kelly, Potter & Dembeck, 2010). Examples of how the NRRA §531(a) will simplify requirements for non-domestic reinsurers is evident when one examines how non-domestic reinsurers will deal with the states of New York and Connecticut. As of July 21, 2011, only New York domestic ceding insurers will have to comply with the New York reinsurance rules. For example, take the case of a Connecticut domestic ceding insurer that is licensed in New York who wants to do business in New York. Before NRRA §531(a) went into effect, the Connecticut company would have to follow all of the regulations for both Connecticut and New York. After NRRA §531(a), the company would no longer required to comply with the New York credit for reinsurance regulations in order to be allowed reinsurance credit in New York. Therefore, where a single beneficiary reinsurance trust is used as the qualifying security by a non-domestic reinsurer, the permitted trust assets will only have to satisfy the Connecticut reinsurance credit rules. The effect of this change will be that the permitted trust asset requirements of the more liberal state, Connecticut, will apply. The same will apply to rules governing letters of credit and other permitted forms of reinsurance security. As a result of this change, any reinsurance agreement entered into by a ceding insurer located in

a more liberal state need only satisfy the more liberal state's reinsurance credit rules as of July, 21, 2011.

A non-U.S. reinsurer that used a multiple beneficiary trust as security for reinsurance ceded by U.S. ceding insurers may not benefit from the preemption effect of the NRRA §531(a) if the trust is intended to qualify for reinsurance ceded by a U.S. ceding insurer domiciled in any state. This is because such a trust must satisfy all needed states requirements for cessions (Dunham, Hill, Kelly, Potter & Dembeck, 2010). However, if the trust was designed to be an eligible security for reinsurance ceded by one or more ceded insurers located in a single state, then the trust need only satisfy the ceding insurer's domestic state reinsurance credit rules as of July 21, 2011. As the majority of multiple beneficiary trust securities are set up to work by matching the cession requirements for all states where business is conducted, there have been little or no changes in how this type of credit for reinsurance business is run in the United States insurance industry.

For existing reinsurance agreements effective before July 21, 2011, the NRRA §531(a) does not modify any contractual requirements of any reinsurance agreement. However, if a reinsurance agreement executed before the before mentioned date expressively states that the reinsurer must provide security that satisfies the reinsurance credit rules for states where business is conducted, this provision will remain in effect even after July 21, 2011. In most of the cases where a provision allows the NRRA §531(a) to not be applicable, the reinsurer has approached the U.S. ceding insurer and requested an amendment to the reinsurance agreement to relieve the reinsurer of having to satisfy more than one state's credit for reinsurance regulations in or after July 21, 2011 (Dunham, Hill, Kelly, Potter & Dembeck, 2010).

For new reinsurance agreements entered into between July 21, 2010 and July 21, 2011, the ceded insurers and reinsurers had two options available. The first option was for the reinsurer to continue to follow any applicable extraterritorial reinsurance credit rules, since those rules still applied until Jul 21, 2011. The second option for handling new agreements for the year in between the creation and effective date of NRRA §531 was for the ceded insurer and the reinsurer to take into consideration the changes that were coming and craft contractual compromise provisions. These would be created in such a way as to assure, by the terms of the reinsurance agreement, the difficulties posed by extraterritorial reinsurance credit rules on the reinsurer would be removed as of the effective date of the Dodd-Frank Act (Dunham, Hill, Kelly, Potter & Dembeck, 2010).

### **Analyzing Changes**

To analyze how the Dodd-Frank Act has made the NAIC, states, territories, and District of Columbia change their credit for reinsurance regulations, New York, California, and the NAIC changes will be discussed. These states and organization have been chosen because these states represent differing levels of regulatory control and conservatism. Debated to be the most conservative in its regulations, New York will be used to demonstrate how conservative states will respond to the changes. California will represent how more liberal states are dealing with the changes to this regulation. Lastly, NAIC will represent how the average state is handling the modifications that are required.

#### *New York*

On November 22, 2010, the New York Insurance Department became the first state to amend their credit for reinsurance regulation (regulation 20) to reflect the required changes brought about by the Dodd-Frank Act. The final version became effective January 1, 2011 and



provides the Superintendent with discretion to reduce the collateral that “approved” unauthorized reinsurers must provide to New York domestic ceding insurers in order for such ceding insurers to receive full financial statement credit for the reinsurance. As stated, this change appears to imply that reductions apply to all reserves under eligible contracts, whenever the business was ceded. The collateral reduction provisions apply to property and casualty as well as life reinsurers that meet the New York Insurance Department’s requirements. This new version of the credit for reinsurance regulation is substantially similar to the NAIC’s approved “Recommendations Regarding Key Elements of the Reinsurance Framework for Accreditation Purposes.”

The new credit for reinsurance regulation changes many key areas of the regulation. One of these changes eliminates New York’s longstanding practice of applying its credit for reinsurance rules on an extraterritorial basis to foreign licensed ceding insurers. In practical effect, New York did not concede too much because the Dodd-Frank Wall Street Reform and Consumer Protection Act gave primacy to the credit for reinsurance rules of a ceding insurer’s domiciliary regulator and preempts all other states’ rules (Kelly, Potter & Dembeck, 2011). Another change to the regulation contains what could evolve into a controversial “principles-based” diversification guideline for ceding insurers. Apart from the requirement to list eight factors that financially prudent reinsurance buyers must consider when purchasing cover, the provision sets out various reporting requirements with respect to diversification. Ceding insurers must notify the New York Insurance Department within thirty days after the portion of the loss reserves that is ceded to reinsurers, called the reinsurance recoverable balance, from a single reinsurer or a group of affiliated reinsurers exceeds fifty percent of the ceding insurer’s last reported policyholders’ surplus. It should be noted that this is not a prohibition, rather it is an

opportunity for the cedent to show “that the exposure is safely managed... including consideration of the financial strength of the reinsurer.” As well as the before mentioned requirement, the ceding insurer must also notify the New York Insurance Department within thirty days after ceding an amount in excess of twenty percent of the insurer’s gross written premium in the previous year to a single reinsurer or group of affiliated reinsurers (Dawson & Mulhern, 2010).

Another area of change for the New York credit for reinsurance regulation is a reduction of collateral that reinsurers must maintain. This amendment is the centerpiece of the new version of the regulation and once again applies to non-US reinsurers. Now, instead of having a fixed collateral amount for non-US reinsurers, the Superintendent of New York has the discretion to allow for reductions in the amount of collateral that must be held in order for the domestic New York ceding insurers to receive full financial statement credit. Before a reinsurer can apply for a reduction of collateral, it must first meet a series of requirements. The first requirement is that the reinsurance company must maintain a policyholders’ surplus or an equivalent fund in excess of \$250 million, calculated on a United States General Accepted Accounting Principles (GAAP) or the United States Standard Accounting Principles (SAP) basis. The second requirement is that the company must be rated by at least two rating agencies that are recognized by the New York Insurance Department. It should be noted that the rating is based on a “stand-alone basis, separate from its parents or any affiliates.” In addition, there must be a memorandum of understanding (MOU) between the Superintendent and the applying reinsurer’s domiciliary regulator that addresses matters that the Superintendent deems relevant “for proper oversight of reinsurance transactions.” The MOUs have been in place between the New York Insurance Department and a number of foreign jurisdictions, including the United Kingdom, Germany,

France, and Bermuda for a number of years. It remains to be seen whether these MOUs will serve as the MOUs under the new regulation or if new MOUs will have to be performed (Dawson & Mulhern, 2010).

Furthermore, for the new amendment for collateral reduction (11 N.Y.C.R.R. §125.1) the Superintendent of New York must assign each reinsurance applicant one of five ratings: Secure-1, Secure-2, Secure-3, Secure-4, or Vulnerable-5. The rating the company receives will determine the amount of reduction for the reinsurance company. Also, the superintendent's rating cannot be greater than the company's lowest rating from Best, S&P, Moody's, and Fitch rating agencies (See Appendix Table 1 for the detailed rating requirements). The collateral required percentages and financial strength rating bands seen in Table 1 in the Appendix are consistent with both the NAIC Reinsurance Regulatory Modernization Act of 2009 and the 2010 NAIC Credit for Reinsurance Model. The financial strength rating is not the only factor that is considered when determining collateral reduction. As part of the evaluation of a reinsurance company several other factors can be considered. The factors evaluated include: the compliance with reinsurance contractual terms and obligations, the business practices of the reinsurer in dealing with its ceding insurers, and the reinsurer's reputation for prompt payment of claims under reinsurance agreements. Also considered are a review of the most recent Annual Statement (for US reinsurers), regulatory actions against the reinsurer, an independent audit of the reinsurer, audited financial statements, liquidation preference of obligations to the ceding insurer in the reinsurer's domicile, a reinsurer's participation in any solvent scheme of arrangement or similar procedure that involves United States cedents, and any other information deemed relevant by the Superintendent (Dawson & Mulhern, 2010).

In order to take advantage of the reduced collateral under the new credit for reinsurance regulation, reinsurance contracts between the ceded insurer and the reinsurer must meet conditions. It is required that the reinsurer notify the ceded insurer in writing within thirty days of any change in the domiciliary license status or its rating status. In addition, the reinsurance contract must include an insolvency clause, and require the reinsurer to appoint a New York agent for service of process and consent to the jurisdiction of United States courts and application of New York law. Furthermore, in order to apply for a reduction, the applicant must pay a non-refundable fee of \$10,000 with annual requalification filings having a fee of \$5,000. Also, audited financials of the reinsurer must be filed annually with the Superintendent of New York along with a certificate of Good Standing from the domiciliary regulator, and a list of disputed reinsurance recoverable balances with the ceding insurer (Dawson & Mulhern, 2010).

It is important to note that the previous collateral requirements where the reinsurer is licensed or accredited by New York and the reinsurer posts one hundred percent of the gross collateral by way of a letter of credit, and a regulation 114 trust agreement is not preempted by the new 2011 credit for reinsurance regulation. The older version has continued to be available as an alternative; however, the majority of companies have chosen to go with the new collateral reduction rules (Dawson & Mulhern, 2010).

The New York amendment to the credit for reinsurance regulation is consistent with the way that Florida, New Jersey has handled this and meets the NAIC recommendations. However, while consistent to the NAIC and other states, these changes are still important and noteworthy modifications to New York's regulation. The state of New York has long been considered to have the most conservative insurance regulations in the United States. These recent changes in New York demonstrate a dramatic transformation in its views of insurance regulation. As seen

with New York, the more conservative states will have to loosen their regulations in order to comply with the changes called for by Dodd-Frank Act and align with the recommendations by the NAIC.

### *California*

The second state to address and take action in regards to the Dodd-Frank Act and NRRA §531 was California. On April 11, 2011, the California Department of Insurance issued Bulletin No. 2011-2 in which the department gave general information to its licensed insurers regarding how the state of California was going to later respond to the NRRA §531. The first statement that the bulletin addressed was the proposed plan for changing their reinsurance credit rules. The bulletin stated that, "The California Department will not deny credit for reinsurance ceded by a nondomestic ceding insurer that has been recognized by the ceding insurer's domestic state insurance regulator. This includes compliance with California's reinsurance collateral requirements, risk transfer rules and required contract requirements" ("Implementation of reinsurance", 2011). After taking on a review of the California Insurance Code ("CIC") and the Title 10 §2303 of the California Code of Regulations ("CCR",) nine sections of the CIC and CCR were discovered to be in need of amending in order to more fully comply with the NRRA demands.

Sections §717(d) in the CIC states that California Insurance Department previously had to consider reinsurance arrangements when deciding whether to grant or continue to give the company authority to participate in the business of insurance in California. The California rule was that a domestic insurer and a nondomestic "volume insurer" had to retain at least ten percent of direct premiums written per line of business ("Implementation of reinsurance", 2011). However, due to changes, this will only apply to domestic insurers and not nondomestic insurers.

Section §700(c) in the CIC and its implementing regulation, 10 CCR §2303.15(q), state that the admitted reinsurer in order to continue business must continue to meet the requirements stated in CIC §717 (“Implementation of reinsurance”, 2011). As these two sections reference license requirements for domestic and foreign insurers that operate in California on an admitted basis, these sections have had to be changed to meet NRRA requirements. The fix for these two sections was incredibly simple. In short, the California Insurance Department merely added the statement, "The Department will not deny financial statement credit for reinsurance that has been recognized by a ceding insurer's domestic state regulator" (Bulletin No. 2011-2).

Another section in need of modification to meet new federal requirements was CIC §922.6. In subdivision (b) of this statute and the implementing regulation found at 10 CCR §2303.10, it gives the Insurance Department the responsibility to disallow financial statement credit that is claimed by a nondomestic insurer. Once again, this section has been modified in the simplest and most efficient manner. This statement was added to the end of section §922.6: "The Department will not exercise that discretion for reinsurance that has been recognized by a ceding insurer's domestic state regulator" (Bulletin No.2011-2). This modification allows for the statutory statement credit oversight authority contained in 10 CCR §2303.3, §2303.11, §2303.12, §2303.13, and §2303.19 will apply only to domestic insurers (“Implementation of reinsurance”, 2011).

Another area of change for the state of California is in how the state approaches reinsurance filing and/or approval requirements. Once again, California has merely removed nondomestic insurers from having to follow the previously required regulations. However, with the same changes as stated above, it is worth examining what is no longer required for nondomestic insurers. The first amendment that was put in place in the new regulation dealt with

section §1011(c) in the CIC. This section of the regulation was changed to state that for reinsurance agreements where the ceding insurer ceded seventy-five percent or more of its total premium or liabilities no longer have to follow section §1011(c) in the CIC. Previously, this section gave the California Insurance Department the responsibility of safeguarding any insurer that had entered into certain reinsurance transactions without having to obtain any prior consent. Once again, a basic statement has been added to the previous section's wording stating that this section will only be applied to reinsurance contracts involving California domestic insurers. However, non-domestic insurers have remained subject to the CIC §1011(c) provisions regarding prior consent to mergers, consolidations and sales transactions ("Implementation of reinsurance", 2011).

It should be noted that in 10 CCR §2303.15(c) (3) a "sale" transaction is defined as any type of assumption reinsurance. Assumption reinsurance is a form of reinsurance where the reinsurer is substituted for the ceding insurer and becomes directly liable for policy claims instead of the reinsurer having the sole obligation to indemnify the ceding insurer who still remains liable for claims on policies it has issued. While not the majority of business assumption, reinsurance is also not uncommon. Therefore, the California Insurance Department seems to be taking the position that the NRRA §533(4) definition of "reinsurance" does not include assumption reinsurance, and that the preemptive effect of NRRA § 531(b) (4) will not extend to assumption reinsurance entered into by nondomestic insurers. At this time, it is unclear if this approach is contradicting the spirit of the NRRAs demand for change and will later bring problems to California. As before, all provisions of CIC §1011(c) and 10 CCR § 2303.15 remain applicable to domestic insurers ("Implementation of reinsurance", 2011).

Another requirement that was removed for nondomestic insurers involved the filing deals for reinsurance agreements where the ceding insurer cedes fifty percent or more of its total premium or total liabilities. After 2010 nondomestic reinsurers are no longer required to file or meet approval requirements from the state. Interestingly, the California Insurance Department also decided that no domestic insurer would be required to make a filing of this kind of reinsurance agreement. Therefore, this change not only loosened regulations for nondomestic insurers but also, in a small way, for domestic insurers too ("Implementation of reinsurance", 2011).

Under the old CIC §1215.13, non-domestic insurers that have met the requirements to be considered a "commercially domiciled insurer" were in general made subject to the rules and requirements set upon them by the California Insurance Holding Company System Regulatory Act ("HCA") as if the company were California domestic insurers. In section §1215.5(b) (3) of the HCA, it requires prior consent to reinsurance agreements or modifications among affiliated insurers in excess of specified thresholds. So, CIC §1215.13 gives the California Insurance Commissioner the right to excuse commercially domiciled insurers from or in some cases all of the requirements that are often required under "circumstances that he or she deems appropriate." In compliance with the NRRA §531 demands, as of July 1, 2011, the Commissioner will exercise his right to declare that all commercially domiciled insurers are exempt from compliance with CIC §1215.5 (b) (3) ("Implementation of reinsurance", 2011).

Large portions of section §2303 in 10 CCR has gone through modifications in order for California's credit for reinsurance regulations to honor the NRRA requirements for foreign insurers. The main areas of change occurred in subsections 11,12,14,15, and 19. Subsection §2303.11 and §2303.12 deal with the implementation of CIC § 922.3 and provide permission for a company with credit for reinsurance as long as the insurer fulfills the requirements for risk



transfers. As was the case for most of California's changes, a statement was merely added to the bottom of these subsections declaring that a non-domestic insurer will not be denied financial statement credit for reinsurance as long as it has been recognized by the insurer's domestic state regulator. Therefore, as of July 1, 2011, these two subsections will only deal with domestic insurers.<sup>10</sup> CCR §2303.14 is the section that implements CIC § 717(d) and puts forth requirements for contract provisions in reinsurance agreements for which statement credit is given and where the agreement is out of the ordinary. This allows the Commissioner the responsibility, under specific circumstances, to find that the insurer's reinsurance arrangement are materially deficient for purposes of CIC §717 and § 700(c). Once again, this section will still serve this purpose; however, it is now stated that the Commissioner cannot exercise his power to make any such decisions for reinsurance agreements that involve a non-domestic insurer (“Implementation of reinsurance”, 2011).

The simple change that California made occurs in 10 CCR §2303.19. Before July 1, 2011, this section stated the procedures applicable for the denial of giving a statement for credit for reinsurance to a company. While nothing was removed from this section, California added that the state could not deny financial statement credit for reinsurance that had been recognized by an insurer's domestic state regulator (“Implementation of reinsurance”, 2011). Overall, California approached all of their CCR changes by making those requirements only applicable to domestic insurers. These changes allowed for the state of California to still maintain control over domestic companies, while at the same time loosening barriers that stopped non-domestic insurers from entering into the insurance business in California.

The last area of change for the state of California is the addition of a new category of reinsurers that was created by using reinsurance collateral. Much like the steps taken by New

York, California agrees to certify reinsurers as long as the company is from a qualified jurisdiction, maintains capital and surplus of at least \$250 million, is rated on a legal entity basis, and maintains financial strength ratings from at least two rating agencies. The new amendment for collateral reduction, much like the New York amendment, allows the Superintendent of California to assign each reinsurance applicant one of five ratings: Secure-1, Secure-2, Secure-3, Secure-4, or Vulnerable-5 (Barney, 2011). The rating the company receives will determine the amount of reduction for the reinsurance company. Also, the superintendent's rating cannot be greater than the company's lowest rating from Best, S&P, Moody's, and Fitch rating agencies (See Appendix Table 2 for the detailed rating requirements). It should be noted, as of January 2012, it appears that California's rating requirements are more conservative than that of New York's but are still slightly more liberal than Indiana, Florida, New Jersey, and the NAIC requirements.

In reality, however, the Dodd-Frank NRRRA should not have much impact on California's regulation of credit for reinsurance. This is because CIC §922.4- §922.9, that generally govern credit for reinsurance with the exception of §922.6, apply only to domestic insurers. Therefore, every section with the exception of §922.6 have remained unchanged. It should be noted that subsection §922.6 was seldom invoked in practice before 2011 and will more than likely now be practiced much in the future (Barney, 2011).

#### *NAIC*

In the last year, the NAIC has also adopted important changes to its Credit for Reinsurance Model Law and Regulation following several years of debate and work on this issue. The new amendments to the NAIC model law and regulation follow the trend of other states and the federal government towards modernization or reinsurance regulations. It is

interesting to note that the NAIC was not the first to amend their model after Congress passed the NRRRA. In 2010, Florida, Indiana, California, New York, and New Jersey preceded the NAIC by several months in making the needed changes (Halahan, 2012).

The first change in the model law and regulation has to do with the regulatory notice regarding cedant's concentration of risk. Under the amendments, an insurer must notify its domestic regulator within thirty days if reinsurance recoverable from any single reinsurer or group of associated reinsurers exceeds fifty percent of the insurer's last reported surplus to policyholders or if the insurer has ceded to any single reinsurer or group of associated reinsurers more than twenty percent of the insurer's gross written premium in the prior year. Also, notification must be given within thirty days if at any time the company believes that it will exceed these limits. The purpose of this requirement is to make the company demonstrate that it can safely manage its exposure. Domestic insurers in states where this amendment is adopted must be certain that their policies governing concentration of risk reflect these new limits (Halahan, 2012).

A new amendment to the model law and regulation by the NAIC requires that the ceding insurer have contractual provisions to obtain credit for reinsurance. The first required provision that a reinsurance agreement must contain is a proper reinsurance intermediary clause, if applicable. This provision states that credit risk for the intermediary is carried by the reinsurer. This clause will be necessary only in situations where reinsurance intermediary handles payment of reinsurance premiums or claims. In addition, the amendment deals with the much debated issue of insolvency clauses. This amendment clarifies that a reinsurance requirement must contain an insolvency clause in order for a ceding insurer to receive reinsurance credit. This change is not a large modification since insolvency clauses already are standard and generally

required in U.S. jurisdictions to obtain credit for reinsurance. The final change under this new amendment requires that reinsurance agreements with a certified reinsurer must contain a funding clause that requires the reinsurer to provide security in an amount sufficient to avoid the imposition of financial statement penalty on the ceding insurer (Halahan, 2012).

The centerpiece of the amendment is the new process by which unauthorized reinsurers may qualify to receive a reduction of collateral in order to satisfy state credit for reinsurance standards that apply to United States cedants. Insurers ceding to a reinsurer, that has been certified, will be granted full credit for reinsurance while being permitted to receive security according to a sliding scale. The level of required collateral varies from zero to one hundred percent of ceded liabilities, according to the certified reinsurer's rating (see Appendix Table 3). The amendment directs the regulator to use the lowest financial strength ratings assigned to the reinsurer in arriving at a rating. As shown in Table 3, the ratings follow a scale of 1 through 6 with varying levels of collateral required to ensure credit for reinsurance. It should be noted that the NAIC rating and factor table provides a floor for collateral requirements, and if a state chooses to maintain its current stricter requirements, the state will still meet the accreditation standards (Halahan, 2012).

The amendments which reduced collateral provisions for a certified reinsurer will apply to reinsurance agreements that are entered into on or after the effective date of the certification. In addition, the amendment states that any agreement that is entered into before the effective date of certification, but is later amended after the effective date, will be eligible for the reduced collateral, but only with respect to losses incurred and reserves reported after the date of the amendment. This amendment limiting effectiveness with respect to in-force business could make it difficult for parties to take advantage of them for existing reinsurance arrangements. For this

reason, it could be three or four years before the impact of this amendment can be quantified by experts in the insurance field. Only at this time will decisions be made regarding whether or not this amendment is a positive or negative change to the credit for reinsurance regulation.

As seen before in states such as New York and California, the NAIC also maintains that in order for a company to be eligible for certification, the reinsurer must meet the following criteria: be domiciled and licensed in a “qualified jurisdiction”, maintain capital and surplus of no less than \$250 million, maintain financial strength ratings provided from two or more approved rating agencies, submit to the jurisdiction of the certifying state and agree to provide security for one hundred percent of its liabilities that relate to business with U.S. insurers and finally the company must agree to provide certain informational filings and comply with other requirements put in place by the certifying state (Halahan, 2012).

NAIC model laws, of course, do not have the force of law in any U.S. jurisdiction; therefore, these amendments are merely recommendations from the NAIC to the states. Although, in the past, many state adopted laws following NAIC models in whole or in part, it remains to be seen how many states will adopt the amendments. This dynamic would change if the NAIC made the adoption of these amendments a condition of state accreditation. In this case, all states would certainly adopt them in full. As it usually takes at least four years for changes in NAIC accreditation standards to become effective, any such development is a long way off (Mankabady, Alberts, Hamilton & Payne, 2011).

### **Discussion on Impact of Changes**

Overall, the changes in the Credit for Reinsurance regulations in the United States have been met with positive, if not slightly indifferent, opinions by the states, territories, and the District of Columbia. The reaction of the states to the changes is difficult to firmly grasp as many

states have seemingly not acknowledged the issue to date. The largest indication that the changes brought forward by the NRRRA are not going to have a significant impact in the way that states have been running their regulation is in the simple fact that only nine states, including Florida, Indiana, New Jersey, New York, and California, as well as the NAIC have seen fit to change their regulation as of January 1, 2012. It is assumed that most, if not all, states will eventually adopt the amendments suggested by the NAIC due to the fact that domestic ceding insurers in states that do not adopt the changes may be competitively disadvantaged in the industry. However, the lack of urgency to amend their regulations is an indication that the states feel it will have little effect on their regulating of reinsurance business (Keir & Romano, 2011).

When it comes to the opinion of the United States insurance industry about the amendments of the credit for reinsurance regulation, there seem to be both positive and negative feelings about the changes. The NRRAs changes make it even easier for nondomestic reinsurers to do business in the United States making foreign reinsurers a huge advocate of the changes. The ease with which the foreign reinsurers can enter into the market however is also advantageous to the domestic ceding insurers. This is due to the fact that it will allow for more reinsurance companies to be in the market making it more competitive overall. For the ceding insurers, this will likely translate into better transactions and reinsurance arrangements as the reinsurance companies will have to cater even more to the ceding insurers in order to do business. The only people who are likely to not be pleased with the required modifications to the credit for reinsurance regulation are the domestic reinsurers (Keir & Romano, 2011). This is due to the fact that the domestic reinsurers now have much more competition than ever before. However, it is too soon to truly tell how large an effect this will have on domestic reinsurers.

The grey area in the changes to the credit for reinsurance regulation is with the new process where companies are now able to reduce the collateral the company can hold by receiving a discount based on their financial ratings. As this is a brand new approach to certifying reinsurers, it is unclear how this will affect the regulating of reinsurance credit or how easy or difficult this makes it for unauthorized reinsurance companies to enter into the United States insurance market. The one thing that is clear is that this addition is in a sense a way for states to continue to voice their own beliefs on the strength of their regulation. After the NRRA, many of the state's individual requirements were taken away and the reduction of collateral seems to be a way for the states to still maintain unique control over the regulations in their state (Keir & Romano, 2011).

Overall, the credits for reinsurance regulation in the United States seems to be here to stay, but will certainly continue to evolve as time progresses. Even with the changes brought about by the Dodd-Frank Act NRRA, many of the controversial issues have been answered. History indicates that the debate will continue regarding the best way to handle reinsurance credit in the United States. However, that being stated, there will more than likely be little or no change for the next decade at least. This is because it will many years, possibly a decade, to understand fully how the new changes are going to affect the credit for reinsurance regulations for domestic insurers and reinsurers and nondomestic reinsurers. Until more experience with these regulations accumulates and the results of the modifications to the regulation are seen, the only thing that can be done is allow the United States insurance industry to adjust to the changes and allow the individual states, the NAIC, and the United States federal government to analyze the changes, so that in the future the government can make informed decisions if amendments are ever needed again.

**Conclusion**

The inclusion of the credit for reinsurance regulation in the United States' multitude of other insurance regulations has a positive effect for the insurance industry and for the policyholders in the United States. Before the creation of this regulation direct insurers would claim ceded risk as an asset merely to increase the business it could write, without placing any thought into the safety of the reinsurer that it was doing business with. These decisions often lead to situations where unstable reinsurers became insolvent and could not pay the ceded insurer the benefits that would then go to the policyholders. The ceded insurer having expanded their business had even less of an ability to pay the benefits leaving the policyholder without the benefits that they were due. The creation of the credit for reinsurance regulation forced the direct insurers to choose reinsurers that were going to be capable of fulfilling any reinsurance agreement by forcing the reinsurers to fulfill strict requirement. This regulation also gave U.S. policyholders more confidence in the insurance industry.

The recent changes to the credit for reinsurance regulation were made to simplify the regulation while still maintaining the purpose of the regulation by making reinsurers follow certain requirements to insure the safety of reinsurance agreements. It is still unclear what these changes truly mean to the insurance industry as any effects of these changes are a few years out. However, professionals in the industry seem to believe that overall the effect of these changes will be positive for the insurance industry. The balance between regulations to protect and regulations that are detrimental to the insurance business is a delicate balance and time will tell if with the recent changes this balance has been reached.



Appendix

Table 1. New York Collateral Required Factors/Ratings

Ratings	Collateral Required	Best	S&P	Moody's	Fitch
Secure-1	0%	A++	AAA	Aaa	AAA
Secure-2	10%	A+	AA+,AA,AA-	Aa1, Aa2, Aa3	AA+, AA, AA-
Secure-3	20%	A, A-	A+, A, A-	A1, A2, A3	A+, A, A-
Secure-4	75%	B++, B+	BBB+, BBB, BBB-	Baa1, Baa2, Baa3	BBB+, BBB, BBB-
Vulnerable-5	100%	B & Below	B++ & Below	Ba1 & Below	BB+ & Below

Table 2. California Collateral Required Factors/Ratings

Ratings	Collateral Required	Best	S&P	Moody's	Fitch
Secure-1	0%	A++	AAA	Aaa	AAA
Secure-2	10%	A+	AA+,AA,AA-	Aa1, Aa2, Aa3	AA+, AA, AA-
Secure-3	20%	A	A+, A	A1, A2	A+, A
Secure-4	80%	A-	A-	A3	A-
Vulnerable-5	100%	B++ & Below	BBB+ & Below	Baa1 & Below	BBB+ & Below

Table 3. NAIC Collateral Required Factors/Ratings

Ratings	Collateral Required	Best	S&P	Moody's	Fitch
Secure-1	0%	A++	AAA	Aaa	AAA
Secure-2	10%	A+	AA+,AA,AA-	Aa1, Aa2, Aa3	AA+, AA, AA-
Secure-3	20%	A	A+, A	A1, A2	A+, A
Secure-4	50%	A-	A-	A3	A-
Secure-5	75%	B++, B+	BBB+, BBB, BBB-	Baa1, Baa2, Baa3	BBB+, BBB, BBB-
Vulnerable-6	100%	B & Below	BB+ & Below	Ba1 & Below	BB+ & Below

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